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TAGS: [ETRD](#) [ECON](#) [CE](#) [ECONOMICS](#)

SUBJECT: SRI LANKA SEES POTENTIAL FOR SAFTA, BUT HEDGING  
WITH ENHANCED INDIA PACT; LESS ENGAGED ON WTO

REF: A. STATE 199861

[1](#)B. COLOMBO 1842

Classified By: Econchief Dean R. Thompson, Reasons 1.4 b, d and e

[1](#)1. (C) Summary: During a wide ranging discussion with Econchief, Sri Lankan Commerce Ministry Director General K.N. Weerasinghe (Note: Weerasinghe is Sri Lanka's senior-most career trade official) said that a successful conclusion to the South Asia Free Trade Agreement (SAFTA) talks was close, but hinged on Bangladesh's willingness to show more flexibility in the talks and stop "hijacking" SAFTA less-developed country (SLDC) issues originally designed to benefit Maldives. Weerasinghe believes a Comprehensive Economic Partnership Agreement (CEPA) with India can be forged by late January, which will expand the current Indo-Lanka FTA. On WTO Weerasinghe was less forthcoming, and previous attempts to engage on WTO issues lead us to believe that Sri Lanka tends to "play defense" on WTO issues from Colombo, leaving their WTO rep in Geneva with fairly wide latitude and engaging only on the most immediate issues that might have negative repercussions on Sri Lankan welfare. End Summary

[1](#)2. (C) Econchief met with Sri Lankan Commerce Ministry Director General K.N. Weerasinghe, Sri Lanka's senior-most career trade official, on November 2. In a wide ranging discussion, Weerasinghe touched on Sri Lankan trade strategy and opinions related to SAFTA, Indo-Lanka trade and the WTO.

SAFTA: CLOSE, BUT BANGLADESHI INITIATIVES GETTING TEDIOUS  
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[1](#)3. (C) When queried about the status of the SAFTA negotiations, Weerasinghe indicated that he refused to attend talks last weekend in Nepal, as Bangladesh and Maldives were unwilling to offer new concessions on issues related to rule of origin and the "compensation mechanism" (Note: the compensation mechanism is a SAFTA-specific initiative to reimburse SLDCs for customs revenue lost to trade liberalization. End note). Weerasinghe said three main sticking points remain on SAFTA: the negative lists, the rules of origin question on apparel (which are linked to the negative list issue), and the compensation mechanism. He suggested that Sri Lanka is relaxed about the potential for SAFTA since, regardless of the SAFTA outcome, Sri Lanka already has FTAs with India and Pakistan.

[1](#)4. (C) On the negative lists, Weerasinghe said all sides are close to agreement, but that Sri Lanka is holding up final agreement, pending Bangladeshi movement on apparel rules-of-origin. Bangladesh has reportedly requested a reduction in value-addition requirements on apparel from the 40 percent SAFTA standard to 20 percent. Sri Lanka would be willing to discuss 35 percent, but could not go to 20 percent, given the interests of their own domestic industry, Weerasinghe commented.

[1](#)5. (C) Under the compensation mechanism, India, Pakistan and Sri Lanka would agree to compensate the SLDCs for customs revenue lost to SAFTA-related trade liberalization. Sri Lanka has complained about this provision of the agreement for months, concerned that any potential gains from increased trade would be offset by compensation requirements. Weerasinghe praised India for coming up with a complex but thorough formula that would separate SAFTA trade from rest-of-the-world trade, and calculate revenue loss based on SAFTA tariff reduction formulas. Weerasinghe thought they were close to agreement, but Bangladesh began requesting the removal of caps on compensation liability (which would be established based on the tariff cutting formulas for SLDCs under SAFTA) and additional compensation based on "trade diversion." Under the trade diversion argument, Weerasinghe explained, as trade is diverted from higher rate countries in the rest of the world to the lower tariff SAFTA nations, Bangladesh believes compensation should be based on the post-diversion SAFTA share of trade (which should potentially be higher than pre-SAFTA trade, based on lower SAFTA tariffs). This is a non-starter for Sri Lanka.

16. (C) Weerasinghe then launched into a short diatribe against Bangladeshi negotiators, indicating that they were intent on "hijacking" issues that were originally meant to help Maldives. According to Weerasinghe, when he raised this point in the last round of meetings, Maldives also acknowledged that they were the original target beneficiary, and that the mechanisms were designed to allow time for Maldives, which is almost completely dependent on customs revenue, to construct a new domestic revenue package.

17. (C) According to Weerasinghe, the final sticking point on the compensation mechanism could prove to be the implementation timeline. Sri Lanka wants the mechanism to begin on entry-into-force of the agreement for three years, with an additional year for Maldives (India and Pakistan reportedly agreed to a "four plus one" formula). Bangladesh wants the mechanism to begin in 2007 (to take into account the trade diversion situation) and to run for seven years.

18. (C) Econchief laid out US interests in SAFTA moving forward, focusing on the importance of increased regional trade for economic development and more harmonious regional relationships. Weerasinghe said that those same issues were the driving force for a January 1 conclusion. He remained hopeful that such an accomplishment is still possible. Weerasinghe believes Bangladesh will ultimately cave on its demands, as participants to the SAARC Summit in Dhaka on November 12 will put pressure on Bangladesh to ensure a successful summit conclusion.

#### India Showing More Creative Leadership on Trade Issues

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19. (C) Weerasinghe expressed great satisfaction with Indian leadership on the SAFTA process, noting that they seemed to be driven more by international perception than by economic factors. India wants to show that it can conclude a regional agreement. Weerasinghe implied that India believes failure to do so would reflect badly on their aspirations in global fora. He said India has proposed a number of far-reaching initiatives, such as a regional economic union (Weerasinghe suggested that a Customs Union would be a more appropriate first step, and complex enough as a task, given the difficulties with SAFTA negotiations). India has also proposed ideas such as linking the Indian and Sri Lankan rupee, allowing the countries to engage in greater rupee-denominated trade, thus protecting foreign exchange reserves. While none of these ideas seemed to be high on Weerasinghe's "to do" list, he was nonetheless impressed with India's initiatives.

110. (C) Weerasinghe said there has been pressure to conclude the CEPA agreement by January 1, but he believes an additional round of meetings will be needed in January to finalize. The rate of progress could depend on the Sri Lankan Presidential elections, however. Weerasinghe believes if Opposition Leader Ranil Wickremesinghe wins, the pressure to conclude the CEPA immediately will be strong.

#### WTO: Tough Issues, Doha Looks Difficult

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111. (C) On the WTO, Weerasinghe, who has previously served as Sri Lanka's Representative to the WTO in Geneva, was far more reserved, seeming almost unaware of some of the bigger issues. When Econchief pressed on the EU agricultural proposals from Ref A, Weerasinghe merely nodded and acknowledged the situation seems to be "mucked up." He said he has been reading more about the proposals and thinks coming to an agreement in December in Hong Kong will be difficult.

112. (C) There could be two issues at play here. First, Weerasinghe is angling to become Sri Lanka's Ambassador to the EU, so he may not want to insert himself into a US-EU spat at this juncture. In previous conversations, he has suggested that he would instruct their current rep in Geneva to raise the issue (Ref B). Secondly, as in previous discussions on WTO issues, Sri Lanka appears to take a more defensive posture, giving its WTO rep in Geneva wide latitude, and looking out for initiatives that could harm their interests and trying to engage with like-minded countries on those.

#### Comment

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113. (C) Weerasinghe is knowledgeable, experienced and a helpful interlocutor on trade matters. If his comments on SAFTA are accurate, then it appears things are moving forward, except for some problematic issues with the Bangladeshis. It's interesting to see how Sri Lanka has become more passive on the WTO, however, from its role in Cancun, where it was recognized as having made efforts to keep the talks, and thus the round, on track. Weerasinghe alluded to some dissatisfaction with the US and EU at the

political level in Sri Lanka, and noted that the Trade Minister had asked him to draft "tough remarks" for the Hong Kong Ministerial, so he could take aim at the US and EU, who are "always asking us to do things, but never giving in return" (Note: in the case of the US, this is clearly a reference to Sri Lankan desire for either an FTA, or duty free access for apparel. End note). Weerasinghe said the Minister's ire has waned of late, however, as he thinks if his party wins the upcoming presidential elections, he will move to a different portfolio (should the opposition win, he will be out completely). End Comment  
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